No. 87-541

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

DANBURY, INC.,

Petitioner,

v.

ANTHONY P. OLIVE, DIRECTOR
BUREAU OF INTERNAL REVENUE
GOVERNMENT OF THE VIRGIN ISLANDS,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

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BRIEF IN OPPOSITION

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QUESTION PRESENTED

Whether a United States corporation, which qualifies as an "inhabitant" of the Virgin Islands under Section 28(a) of the Virgin Islands Revised Organic Act, owes tax on its worldwide income to the Virgin Islands.

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BRIEF IN OPPOSITION

Respondent, Anthony P. Olive, Director, Bureau of Internal Revenue of the Government of the Virgin Islands (hereinafter "VIBIR"), opposes the Petition for a Writ of Certiorari. The Petition raises no issue worthy of review by this Court. On the precise tax question presented, there is no conflict among the circuits, there is no contrary ruling by this Court, nor has there even been a final tax assessment in the case at issue.

Respondent does not challenge Petitioner's assertions under the headings of Opinions Below, Jurisdiction, and

Statutory Authority Involved. Respondent does challenge Petitioner's Statement Of The Case. Because the Petition omits relevant facts and conclusions necessary to understand the decision below, Respondent submits the following statement.

STATEMENT OF THE CASE

This case involves an attempt by the Petitioner, a U.S. corporation chartered in Nevada, to avoid any tax on all of its U.S. source investment income. Petitioner structured its corporate activities to qualify as an "inhabitant" of the Virgin Islands under the Revised Organic Act of the Virgin Islands, while claiming that it is only subject to tax as a "foreign corporation" under the Territory's "mirror tax" code. The company argues that its U.S. source income is foreign source income under the Virgin Islands mirror code and, thus, not taxable by the Territory. At the same time, the company claims that it owes no U.S. tax because, as an "inhabitant" of the Virgin Islands, it satisfies its entire U.S. income tax obligations by filing its tax returns in and paying its applicable tax under the mirror code to the Virgin Islands.

The United States Court of Appeals for the Third Circuit rejected this "creative" interpretation of the Revised Organic Act of the Virgin Islands and this Petition for a Writ of Certiorari followed.

A. The Undisputed Facts Giving Rise To This Case

The facts underlying the dispute are, as the court below noted, "simple and uncontested." (Petition No. 87-541 For a Writ of Certiorari (hereinafter "Pet."), Petition Appendix (hereinafter "Pet. App.") 21a). Petitioner is a U.S. corporation which is "a holding company for the investments of its two [individual U.S.] shareholders." (Pet. App. 21a). "Although incorporated under the laws of Nevada, [Petitioner] keeps all its corporate documents at its sole office in the Virgin Islands, maintains a

Virgin Islands bank account, and holds all its shareholders' and directors' meetings in the [Territory]." (Pet. App. 21a). On the basis of these stipulated facts, Petitioner was found to be a permanent resident and, thus, an "inhabitant" of the Virgin Islands under the Territory's Revised Organic Act of The Virgin Islands, ch. 558, § 28(a), 68 Stat. 508 (1954) (codified as amended at 48 U.S.C. § 1642 (1982)) (hereinafter "ROA"). (Pet. App. 27a).

Petitioner filed a Virgin Islands income tax return for 1981 with the VIBIR, disclosing income of $256,118, but paying no tax. (Pet. App. 21a). Petitioner filed its 1982 income tax return with VIBIR, disclosing "taxable income" of $96,985 and other income of $526,057.55 and paid VIBIR a total of $26,243 on its 1982 return. (Pet. App. 21a-22a). Petitioner's reported income on its 1981 and 1982 returns, other than the income reported as taxable, was derived from sources outside of the Virgin Islands and was income not effectively connected with a Virgin Islands trade or business. (Pet. App. 22a). Petitioner did not file an income tax return for either 1981 or 1982 with the U.S. Internal Revenue Service (hereinafter "IRS"). (Pet. App. 22a).

The VIBIR issued a statutory notice of deficiency to Petitioner in the amount of $97,750 for tax year 1981 and $240,607 for tax year 1982, stating that, under the ROA of the Virgin Islands, Petitioner owed tax to the Virgin Islands on its worldwide income. (Pet. App. 22a). Petitioner then filed a petition for redetermination of the asserted tax deficiency in the District Court of the Virgin Islands.

B. The Applicable Taxing Statutes Of The Virgin Islands

At the time this action was filed in the district court, a Virgin Islands inhabitant company incorporated in the United States—such as Petitioner—was obligated to pay taxes into the Virgin Islands treasury pursuant to two statutory sources. First, the Naval Service Appropriation Act, 1922, ch. 44, § 1, 42 Stat. 123 (1921) (codified

as amended, at 48 U.S.C. § 1397 (1982)), established the "mirror tax" system, under which the U.S. Internal Revenue Code (hereinafter "IRC") is "mirrored" in the Virgin Islands by substituting the words "Virgin Islands" for the words "United States" in the IRC (hereinafter "mirror code"). (Pet. App. 23a). Under the Virgin Islands mirror code, Petitioner is obligated to pay taxes to the Virgin Islands on its Virgin Islands source income and income effectively connected with a Virgin Islands trade or business. 26 U.S.C. § 882(b) (1982) (mirrored). (Pet. App. 27a-28a).

Second, Section 28(a) of the ROA, enacted by Congress in 1954, directs that a U.S. corporation, which qualifies as an "inhabitant" of the Virgin Islands, shall satisfy its separate U.S. income tax[1] by paying its applicable tax under the IRC to the Virgin Islands (hereinafter the "inhabitant rule"). Section 28(a) provides, in pertinent part:

> [T]he proceeds of customs duties, the proceeds of the United States income tax, [and] the proceeds of any taxes levied by Congress on the inhabitants of the Virgin Islands . . . shall be covered into the treasury of the Virgin Islands . . . *Provided*, That the term "inhabitants of the Virgin Islands" as used in this section shall include all persons whose permanent residence is in the Virgin Islands, and such persons shall satisfy their income tax obligations under applicable taxing statutes of the United States by paying their tax on income derived from all sources both within and outside the Virgin Islands into the treasury of the Virgin Islands. . . .

ROA, 48 U.S.C. § 1642.

To ensure proper application of the "inhabitant rule" set forth in Section 28(a) of the ROA, Congress also enacted an ordering rule in the IRC, which provided:

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[1] The U.S. Internal Revenue Code (hereinafter "IRC") imposes tax on a U.S. corporation's worldwide income, 26 U.S.C. § 61 (1982 and Supp. III 1985), but generally provides a foreign tax credit for taxes paid to the Virgin Islands. 26 U.S.C. §§ 901-908 (1982 and Supp. III 1985).

> For the purposes of this title . . . section 28(a) of the Revised Organic Act of the Virgin Islands shall be effective as if such section had been enacted *subsequent* to the enactment of this title.

26 U.S.C. § 7651(5)(B) (1982 and Supp. III 1985) (emphasis added). Consequently, the provisions of the "inhabitant rule," requiring payment of taxes into the Virgin Islands treasury, superseded the provisions of the IRC that would have otherwise required Petitioner to pay its tax on its worldwide income to the IRS. Thus, the Naval Service Appropriation Act (mirror code) and the ROA, as described above, constituted the basic tax structure of the Virgin Islands at the time the Petitioner contested the VIBIR statutory notice of deficiency in the Virgin Islands District Court.

After the decision by the district court and while this case was pending on appeal, Congress enacted the Tax Reform Act of 1986, Pub. L. No. 99-514, § 1275, 100 Stat. 2085, 2598 (1986) (hereinafter "TRA-86"), which, *inter alia*, amended 26 U.S.C. § 7651(5)(B) to modify the application of the "inhabitant rule" of Section 28(a) of the ROA for certain tax years.[2] Pursuant to Section 1277(c)(2) of the TRA-86, this amendment was made effective only for (1) all tax years commencing after December 31, 1986, and (2) certain "pre-1987 open years." 100 Stat. at 2601.[3]

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[2] In particular, the Tax Reform Act of 1986, Pub. L. No. 99-514, § 1275, 100 Stat. 2085, 2598 (1986) (hereinafter "TRA-86") amended the ordering rule in the IRC to read:

> For purposes of this title, section 28(a) of the Revised Organic Act of the Virgin Islands shall be effective as if such section 28(a) had been enacted *before* the enactment of this title and such section 28(a) shall have no effect on the amount of income tax liability required to be paid by any person to the United States.

26 U.S.C.A. § 7651(5)(B) (Supp. 1987) (emphasis added).

[3] The TRA-86, under § 1277(c)(2)(C), defines a "pre-1987 open year" as any taxable year beginning before January 1, 1987, "if on the [October 22, 1986] date of enactment of this Act, the

For tax years to which the modified "inhabitant rule" established by TRA-86 applies, a U.S. corporation which is an inhabitant of the Virgin Islands is required to pay (1) tax on its Virgin Islands source and effectively connected income under the mirror code to the Virgin Islands, and (2) tax on its worldwide income under the IRC to the United States, with a foreign tax credit for taxes paid to the Virgin Islands.

C. The Decisions Below

On cross motions for summary judgment, the district court held that the Petitioner was subject to tax only on its Virgin Islands source income and on income effectively connected with a Virgin Islands trade or business. (Pet. App. 2a). The district court reasoned that the "inhabitant rule" could not be construed to alter the distinction between domestic and foreign corporations or to amend the sourcing rules under the Virgin Islands mirror code. (Pet. App. 12a-14a).

Relying on the plain language of Section 28(a), the court of appeals reversed the judgment of the district court, holding that the court had erred in viewing the case as an attempt by the VIBIR to amend the mirror code. (Pet. App. 21a, 30a and 34a). The court held that the "inhabitant rule" did not operate to extinguish a corporate inhabitant's liability for U.S. taxes, but simply directed an "inhabitant," such as Petitioner, to pay both its U.S. and V.I. tax liabilities to the Virgin Islands. Thus, the court of appeals concluded "that the district court should have awarded the [VIBIR] summary judgment . . . ." (Pet. App. 34a).

However, the court of appeals noted that a final disposition of this case could not be ordered until the effect of the intervening enactment of TRA-86 was assessed.

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assessment of a deficiency of income tax for such taxable year is not barred by any law or rule of law." 100 Stat. at 2601.

(Pet. App. 35a-41a). Based on its analysis of that intervening Act, the court ruled that Petitioner would be required to pay both its mirror tax and U.S. tax liabilities for the 1981 and 1982 tax years in question to the VIBIR, unless such tax years constituted "pre-1987 open years" within the meaning of the effective date provisions of TRA-86. (Pet. App. 37a and 41a). The court held that the general three-year statute of limitations would have barred any additional assessment of income tax by the IRS at the time of enactment of TRA-86. Thus, the tax years in question would be "pre-1987 open years" *only* if Petitioner were found to have filed a false return or willfully attempted to evade tax. (Pet. App. 40a). The court of appeals thus remanded the case to the district court to make the necessary factual determinations on this limited issue and to enter an appropriate final order. (Pet. App. 40a-41a).

REASONS FOR DENYING THE WRIT

The decision below and disposition of this case by the court of appeals raise no issue worthy of review by this Court. As to the court of appeals' interpretation of the pre-TRA-86 "inhabitant rule" of the ROA, the decision below does not conflict with the decisions of any other circuit, was correctly decided, and does not present any other basis for granting the writ. Moreover, the only practical dispute between the parties to this case—whether VIBIR can collect the tax deficiencies assessed for 1981 and 1982—has been remanded to the district court for further fact-finding to determine whether Petitioner must pay the disputed deficiencies to the VIBIR. Consequently, the issues raised in the petition concerning the court of appeals' interpretation of TRA-86 lack the finality normally required to present a matter worthy of review by this Court.

A. The Decision Below Is Not In Conflict With The Decisions Of Any Other Circuit And Is Fully Consistent With Prior Precedent

Contrary to Petitioner's assertion, there is *no* conflict between the decision below and the decisions of any other circuit. The sole case relied upon by Petitioner—*Commissioner v. Rivera's Estate*, 214 F.2d 60 (2d Cir. 1954)—is simply inapposite. While both this case and *Rivera's Estate* involve interpretation of tax provisions, they involve entirely different and distinct tax laws and facts.[4] Inconsistencies in *dicta* or in the general principles utilized in these cases, if any, are insufficient to establish a conflict between the circuits. *See Layne & Bowler Corp. v. Western Well Works, Inc.*, 261 U.S. 387, 392-93 (1923); *Keller v. Adams-Campbell Co.*, 264 U.S. 314 (1924); *Wisconsin Electric Co. v. Dunmore Co.*, 282 U.S. 813 (1931).[5]

Nor is there any inconsistency between the decision below and prior Third Circuit precedent. As the Third Circuit tacitly acknowledged when it denied Petitioner's request for *en banc* rehearing, no such conflict exists between the decision below and the Third Circuit's earlier decision in *Dudley v. Commissioner of Internal Revenue*,

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[4] This case involves income taxes, under the U.S. Internal Revenue Code and the Revised Organic Act of the Virgin Islands, ch. 558, § 28(a), 68 Stat. 508 (1954) (codified as amended at 48 U.S.C. § 1642 (1982)) (hereinafter "ROA"), payable to the Virgin Islands, and facts related thereto. *Commissioner v. Rivera's Estate*, 214 F.2d 60 (2d Cir. 1954) involved U.S. estate taxes, a Puerto Rican estate, and facts related thereto.

[5] It is unlikely that there could ever be an inconsistency between the Third Circuit and any other circuit involving Virgin Islands tax matters. *See* 28 U.S.C. § 1291 (1982); 48 U.S.C. § 1612 (1982 and Supp. III 1985). *See also Dudley v. Commissioner of Internal Revenue*, 258 F.2d 182, 188 (3d Cir. 1958) (U.S. Tax Court has no jurisdiction over petition for redetermination of tax deficiency issued by Virgin Islands; Virgin Islands District Court has exclusive jurisdiction over such cases).

258 F.2d 182 (3d Cir. 1958).[6] That case involved a Virgin Islands taxpayer who petitioned the Tax Court of the United States—rather than the District Court of the Virgin Islands—for a redetermination of his Virgin Islands income tax liability. In affirming the Tax Court's dismissal of the petition for lack of jurisdiction, the court of appeals held that the tax in dispute was a territorial tax, imposed under the Virgin Islands mirror code, and not a tax of the United States. *Id.* at 185. At the same time, the court distinguished the territorial tax under the mirror code from the separate U.S. income tax obligations that Section 28 of the ROA requires an inhabitant to pay into the Virgin Islands treasury. *Id.* at 188.[7]

Thus, both *Dudley* and the decision below stand for the proposition that a Virgin Islands inhabitant is subject to both Virgin Islands mirror tax and U.S. income tax. Indeed, both cases recognize that, under the "inhabitant rule" set forth in Section 28(a) of the ROA, a Virgin Islands inhabitant shall satisfy its U.S. and V.I. income tax obligations by paying both taxes to the Virgin Islands. *Accord* Rev. Rul. 80-40, 1980-1 C.B. 175; *see also Vitco, Inc. v. Government of the Virgin Islands*, 560 F.2d

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[6] Petitioner also relies on *HMW Indus., Inc. v. Wheatley*, 504 F.2d 146 (3d Cir. 1974), *Pan American World Airways, Inc. v. Duly Authorized Government of the Virgin Islands*, 459 F.2d 387 (3d Cir. 1972), and *Chicago Bridge and Iron Co. v. Wheatley*, 430 F.2d 973 (3d Cir. 1970), *cert. denied*, 401 U.S. 910 (1971). The quotations from these cases, on which Petitioner relies, are inapposite. They involve interpretation only of the Naval Service Appropriation Act (i.e., the mirror code tax) and *not* an "inhabitant's" liability for U.S. income tax under the ROA.

[7] Petitioner suggests that the decision below will cause disarray and chaos for Virgin Islands inhabitants. (Pet. 18). In order to suffer from such confusion, one must wholly fail to recognize the distinction between the taxing authority granted to the Virgin Islands by the Naval Service Appropriation Act which created the "mirror code" and the additional collection authority granted under the ROA of 1954 which created the "inhabitant rule" set forth in Section 28(a).

180 (3d Cir. 1977) (Virgin Islands corporation is an "inhabitant" corporation taxable by the Territory on its worldwide income, notwithstanding minimal contacts in the Virgin Islands), *cert. denied*, 435 U.S. 980 (1978); *Chicago Bridge and Iron Co. v. Wheatley*, 430 F.2d 973, 974 n.1 (3d Cir. 1970) (ROA provides that corporate inhabitants of the Virgin Islands "must return and pay taxes to the Virgin Islands on income from all sources"), *cert. denied*, 401 U.S. 910 (1971).

In any event, the existence of conflict within a circuit is not a sufficient basis for granting certiorari. *See Davis v. United States*, 417 U.S. 333, 340 (1974). Such conflicts are intramural in nature and are to be resolved by the circuit through *en banc* proceedings pursuant to Rule 35(a), Federal Rules of Appellate Procedure. Fed. R. App. P. 35(a).

B. The Decision Below Does Not Present Any Issue Concerning The TRA-86 That Is Ripe For Review By This Court

Petitioner raises numerous constitutional and other challenges to the interpretation and application of the TRA-86 by the court below. Because the court of appeals remanded the case, however, none of those issues is "yet ripe for review by this Court." *Brotherhood of Locomotive Firemen & Enginemen v. Bangor & Aroostook R.R. Co.*, 389 U.S. 327, 328 (1967). Indeed, certain issues raised by the Petition, such as the asserted unconstitutional retroactive application of the TRA-86 (Pet. App. 12 and 16; Pet. App. 36a n.4), are not issues raised by this case at all.

Petitioner does not contend that an order requiring the payment of tax deficiencies to the VIBIR would be a retroactive application of the TRA-86. In fact, Petitioner flatly asserts that "Danbury's 1981 and 1982 income taxes, if any, are properly payable to the Virgin Islands . . . ." (Pet. 13). On remand, the district court will

only decide whether Petitioner must pay the assessed deficiencies to the Virgin Islands.[8] Thus, this case does not at this time, and will not when finally resolved, raise the "retroactive application" issues which Petitioner argues. Those issues will be presented, if ever, only in a case where the IRS issues and seeks to enforce, against Petitioner or a similarly situated corporation, a timely notice of tax deficiency for a "pre-1987 open year." Therefore, the arguments in Sections III, V, VI and VII of the Petition (Pet. 10-11 and 12-17) need not be addressed at all in resolving this case and present no basis for review of the decision below by this Court.

This Court's review of the decision below is unwarranted, moreover, because of the character of the underlying complaint. The decision below may disappoint these taxpayers' ill-conceived expectation of avoiding payment of any tax on their U.S. source income—an expectation which the court below described as founded solely on "the 'creative' analysis offered by [an] article in Tax Management, [a private publication,] rather than [on] a rational consideration of the actual taxing and administrative statutes." (Pet. App. 34a). But, taxpayers have no reasonable expectation to escape taxation. This Court has repeatedly held that taxation is neither a penalty nor a liability governed by contract principles but merely a way of apportioning the costs of government among those who enjoy its benefits. *See Welch v. Henry*, 305 U.S. 134, 144 (1938). Accordingly, the courts have consistently read tax statutes to cure defects and eliminate potential abuses of specific provisions of the tax code. *See Graham & Foster v. Goodcell*, 282 U.S. 409 (1931). Here, no liberal interpretation of the ROA was required to reject the tax avoidance scheme asserted by Petitioner. The language and meaning of Section 28(a) are plain. In

[8] Petitioner appears to recognize that the District Court for the Virgin Islands does not have jurisdiction in this case to entertain an action on a statutory notice of deficiency issued by the IRS. (Pet. 11).

order to satisfy its U.S. income tax obligations under the inhabitant rule, Petitioner must pay its applicable U.S. tax to the Virgin Islands.[9]

CONCLUSION

The opinion below is correctly decided, does not conflict with any precedent of this Court or, indeed, of any other court, and, in any event, has caused no final assessment of tax deficiency to be made. Thus, no basis exists for granting the Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit. Respondent respectfully requests that the Petition be denied.

Respectfully submitted,

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[9] To the extent a risk of double taxation may arise as a result of a taxpayer's status in any particular case, the tax authorities of the Virgin Islands and the United States have established procedures to resolve any conflicts between the two taxing jurisdictions. *See* Rev. Proc. 80-57, 1980-2 C.B. 852.